

Agricultural Development-Marketing Nexus: Is Tengkulak truly Enemy of Smallholders in Indonesian Rural Area?

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ABSTRACT

This paper notes that a serious difficulty of smallholders in Indonesia is improving marketing networks of agricultural products. The marketing network in rural area is dominated by the brokers (called tengkulak). Smallholders do not have options to finance their production except for borrowing capital input from the tengkulak. Then the tengkulaks' money will be repaid by smallholders in terms of agricultural products. It is true that smallholders get capital input, as well as daily life desires easily, on one hand. However, it also true that smallholders have no choice and they are 'choked' by the tengkulak in terms of price discrimination on the other hand. This phenomenon affects smallholder's income. However, the tengkulak plays an important role in smallholder community. The first role is Financial/Capital Input provider. The tengkulak provides access to capital inputs for smallholders who are not able to get formal credit (banks). The second role is Production Process. The tengkulak facilitates smallholders in providing agricultural inputs. The third role is of Post-Production/Marketing. The tengkulak enables smallholders to sell their agriculture products easily. The forth is Socio-religious role. Smallholders need money for schooling fees, medical care, donation for socio-religious activity by borrowing money from tengkulak without any administrative procedures. These facts above depicts that tengkulak is not truly enemy for smallholders.

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Keywords:

brokers (tengkulak); smallholders; agricultural marketing

1. Introduction

Marketing is a long standing issue in agricultural economic activity in developing countries, both organic and anorganic agriculture. Parvathi and Waibel (2013) highlighted the constraints of marketing organic products from developing countries under fair trade regimes. In many countries around the world, support for local agriculture has been a burgeoning issue involving the development of the local foods movement as an alternative marketing (Arsil *et al.*, 2014). Another important issues are recognizing export knowledge, selling and marketing skills, and knowing business rules and regulations (Igdir *et al.*, 2015), a weak of marketing agencies and institutional aspects (Nuddin *et al.*, 2015; Sefriadi, 2013), improving market co-integration

(Susanawati *et al.*, 2015), considering international marketing in agribusiness competitiveness (Fischer, 2010), the lack of access to market information for both farm input and output, High Yielding Clone or agricultural extension, as well as non-agricultural business opportunities for smallholders (Arsyad and Kawamura, 2010), exposure to production shocks such as drought, access to input and output markets (Mutenje *et al.*, 2016), integration, advancement of technology, and continued improvement (Aziz and Chock, 2012) necessary to find new marketing strategies and innovations (Colom-Gorgues, 2009), understanding (1) the architecture, or networks and institutions, of commercialisation, governance and certification and (2) the marketing practices and strategies, designed to resonate with and develop cognitive association amongst consumer (Doherty *et al.*, 2015), impact of price transmission on agricultural commodity markets under different volatility regimes (Ganneval, 2016) including transaction cost issue in the market system, due to transaction costs play a fundamental role in production specialization in agriculture, which in turn affects household decisions on market entry and the extent of market participation (Wickramasinghe, 2015) are also crucial matter in improving marketing channels. In addition, the orientation of agricultural production ('agricultural sector' in a broad sense) is strongly and directly associated with rural poverty reduction (Yuwono *et al.*, 2010], including communication pattern and agricultural extension (Ekasari *et al.*, 2013) in enhancing production itself.

Many researchers found that marketing improvement can be expected to increase smallholders welfare both direct and indirectly. For example, Olwande *et al.* (2015) persuasively reported that commercializing smallholder agricultural production is one of the effective ways to boost farmer incomes, employ labor, and stimulate rural economies in Sub-Saharan Africa. The decision to sell to the cooperative induces an anti-competitive effect on the direct selling market. The cooperative facilitates collusion on the local market by making farmers softer competitors on that market. Conversely, direct selling may create a "healthy emulation" among farmers, leading to more production benefiting the cooperative (Salanié *et al.*, 2015). In addition, stepping up of agricultural extension, including market information (based on social learning process) which becomes a push factor towards independency group in finding new innovation (Ekazari *et al.*, 2013) is one of the primary policy instruments to get high income for smallholders in rural area. Therefore, commercialization pathways, and the features of the rural transformation that these generate, will depend on the farming system, market institutions, and policy frameworks. Contextual understanding is fundamental, including which commodities and value chains are most likely to enable participation by large numbers of smallholder farmers (Olwande *et al.*, 2015) towards smallholders welfare improvement. Given the current conditions above, it is very clear that developing countries have been keeping agricultural products marketing issue to solve, and Indonesia is no exception. It is now really necessary to note agriculture-marketing nexus and inquiry whether or not brokers (called *tengkulak*) truly enemy of smallholders in Indonesian rural area.

2. Marketing Networks

In general, one of the common difficulties for smallholders in Indonesia is improving marketing networks for agricultural products. The marketing networks in the rural areas are dominated by the broker/middlemen/collector called *tengkulak* (see Figure 1 of Marketing Networks). Presently, smallholders do not have flexible options to finance their production except for borrowing capital input (money) from the *tengkulak*.

Then the *tengkulaks*' money will be repaid by the smallholders in terms of agricultural products. In many parts of rural Indonesia, it is easy to find *tengkulaks* who offer their capital (as a credit) to the smallholders on the condition that smallholders have to sell their products to the *tengkulak*. In this particular case, it is true that the smallholders get the capital input, as well as daily life desires easily, on one hand. However, it also true that smallholders have no choice and they are 'choked' by the *tengkulak* in terms of price discrimination (below prevailing market price) on the other hand. This phenomenon affects smallholder's income as a whole.

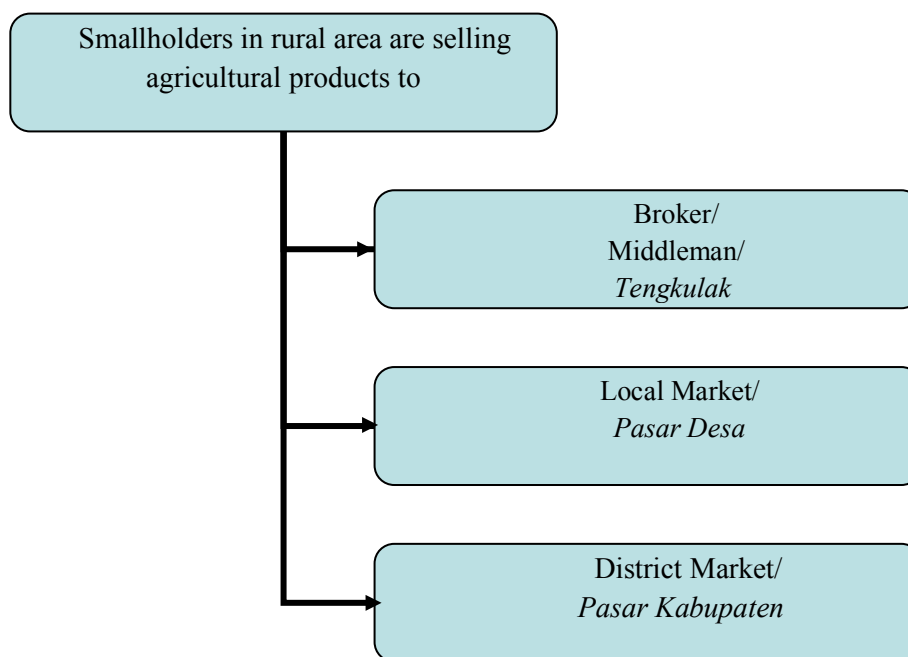


Figure 1. Marketing Networks of Agricultural Products

A study conducted by PENSA in 2005 found that price information is relatively clearly transmitted between exporters and provincial traders, and even to village-level traders and collectors. However, this "highly competitive and efficient" marketing system appears to then break apart at the exchange between farmer and collector. The price received by farmers varies considerably between farmers in a particular area, and between other different geographic areas. The principal reason for wide variability at the farmer level is the role played by the village collector. These collectors are often referred to as *tengkulak* in Indonesia, which is a slightly derogatory expression for traders who ensure exclusive supply of a commodity from a farmer by tying the farmer in informal debt. Interestingly, the institution of the *tengkulak* is well accepted by many farmers, despite apparently having a strong negative influence on depressing prices. The *tengkulak* offers a service which most banks reject: he accepts cocoa pods on the tree as collateral against a loan. The farmer can easily obtain cash advances for daily needs, emergency medical situations, or agricultural inputs, and is not restricted to bank operating hours. The *tengkulak* often live in the farming community and may be tied to the farmers by social and family relationships as well as economic ones. During the harvest, the *tengkulak* will usually collect semi-dried beans directly from the farmer in payment for a loan, the interest on which is collected by a reduced farm gate price. The size of this reduction may be discussed between the parties when the initial

advance is made, although frequently the *tengkulak* will determine a suitable reduction at the time of collection only.

3. Role of *Tengkulak*

It is important to note that the presence of *tengkulak* in Indonesia is deemed as an “enemy” of the farmers under the fact that the *tengkulak* purchases agriculture products from the farmers at a lower price (but the *tengkulak* plays some important socio-economic functions in the community which will be discussed later). This phenomenon is supported by the research findings below. Arsyad (2010) found that one of the common poverty causal factors is “Agricultural Marketing”. He persuasively explained that, the factor has indirect effect on the poverty. It is true that its total indirect effect is a negligible association (indirect effect of less than 1.00%, however, an interesting point on this particular fact finding is that, the index “Agricultural Marketing” as a variable in his regression gives a different sign of total indirect effect. Therefore, the interpretation could be the higher frequencies of selling agricultural products to the brokers and local market cannot be expected to reduce poverty. Meanwhile the higher frequencies of selling agricultural products to the district market, the higher income of smallholders will be, indicating poverty reduction. All these indicate that linking smallholders to the district market directly is crucial way to increase smallholders income.

In response, it will be important to re-note that smallholders sell their products: [1. to the brokers; 2. local/village market (*Pasar Desa*) and 3. district market (*Pasar Kabupaten*)]. To enrich our understanding on “Agricultural Marketing” it will be also helpful to explain by three important sides. Firstly, from the broker side--bringing and selling agriculture products to the broker or broker coming to smallholders’ house--. This phenomenon affects smallholders’ income as a whole due to the broker/*tengkulak* purchase agricultural products are below prevailing market price. Ironically, as clearly depicted (Arsyad and Kawamura, 2010), about 30.29% smallholders sold their products to the brokers, 69.71% to the local market (*Pasar Desa*) without any chance to sell to the district market (*Pasar Kabupaten* of 0.00%) in which the prices are more perfect competition. Therefore, there is a high possibility of having negative influences of selling products to the brokers on smallholders’ income due to price discrimination (below prevailing market price). In other words, smallholders less economically benefits by selling agricultural products to the brokers.

Secondly, from the local market side, this corresponds to the frequency of selling agriculture products to the local market--mean nearest market or village market (so called *Pasar Desa*)--. The rational of smallholders for running this way relies on their expectation that by selling products to the local market (not to the brokers) they can get relatively higher prices. As mentioned above, 69.71% smallholders sold their products to the *Pasar Desa*. Unfortunately, the buyers in *Pasar Desa* are also strongly dominated by the broker themselves. Therefore, there is also a high possibility of having negative impact of selling products to *Pasar Desa* on smallholders’ income.

Thirdly and equally important, smallholders are very difficult to reach *Pasar Kabupaten* or district market in the capital city of where agriculture products are sold in more perfect competition with many traders (not only brokers). This is totally different from the ‘monopoly’ system run by the brokers in more remote rural area. In addition, in terms of distance to the capital city of kabupaten (district), with a deplorable road situation, smallholders had difficulty to reach the market even if by motorcycle. This is

a reason why smallholders don't have a better position to monitor the prices in the market so that they don't have better opportunities to sell their products at more competitive price which will eventually lead to lower income.

Based on the justifications explained above, it is clear that "Agricultural Marketing", through existing marketing network, cannot be expected to increase smallholders' income, so called agriculture-marketing nexus. This also leads us to argue that selling products to the *Pasar Kabupaten*, directly, is an important way of avoiding the strong influences of the brokers, in terms of price discrimination. In addition, optimizing the role of agricultural marketing, by facilitating free market competition among the brokers in the rural area in order to reduce the 'monopoly' system that is run by the brokers by giving capital input (as money lenders), and also purchasing the smallholders' agricultural products at low prices.

However, based on the observation during the field trip, it was found that the *tengkulak* plays an important role in the smallholders community as displayed in Figure 2. The first role, is as Financial/Capital Input provider. The *tengkulak* provides access to capital inputs for the smallholders who are not able to get formal credit through the banks or commercial financial institutions in financing the farming activity and daily life desires; meaning that the *tengkulak* plays an important economic role in the smallholders' daily life which, otherwise, is not met by the banking sectors. In other words, *tengkulak* helps smallholders in sustaining their access to capital and financial resources for agricultural economic activity.

The second role, is as Process Production provider. The *tengkulak* also takes responsibility to facilitate smallholders in providing agricultural inputs (non-cash) such as fertilizer, seeds, farm equipments etc in production process. It is true that the prices of those inputs are dominantly higher than the prevailing market price, but it is also true that the *tengkulak* offers an easy way for the smallholders to get the inputs and farm equipments needed as production factors. One of the considerations is that those inputs are sold by the wholesaler or farm cooperatives in the capital city, which are far from the smallholders' residences. This is also a reason why smallholders decide to use the *tengkulak's* services.

The third role, is of Post-Production/Marketing. One of the main advantages of the *tengkulak* is that they enable smallholders to sell their agriculture products easily. The reason is that the *tengkulaks* (as buyers) come to smallholders', house so that the smallholders do not need to go to the market (*Pasar Kabupaten*, for instance) which is usually far from their residence. In addition, smallholders sell the agriculture products to the *tengkulak* simply because the nearest local market day (*hari pasar*) is not held everyday at a very inappropriate market infrastructure with deplorable road networks. Given the situation, selling the agriculture products to the *tengkulak* is one of the better choices for the smallholders. It indicates that the dependency of the smallholders on *tengkulak* is stronger. This conveys a message that it is needed to improve agricultural marketing system or networks in more perfect competition (with better market infrastructure and road networks), which in turn can be expected to increase smallholders income. Therefore, the government should focus on this particular matter to solve in promoting smallholders potency in getting farming capital. Rudito (2014) pointed out that promoting a change in a particular community should be driven by the community awareness itself and their indigenous knowledge to understand in order to realize its own potential, so that program is able to show considerable promise in providing the access, convenience, and flexibility desired by

poor borrowers while assuring the financial viability of the credit institution by minimizing administrative costs and imposing interest rates sufficient to cover costs and prevent capital erosion (Riedinger, 1994) towards smallholders welfare.

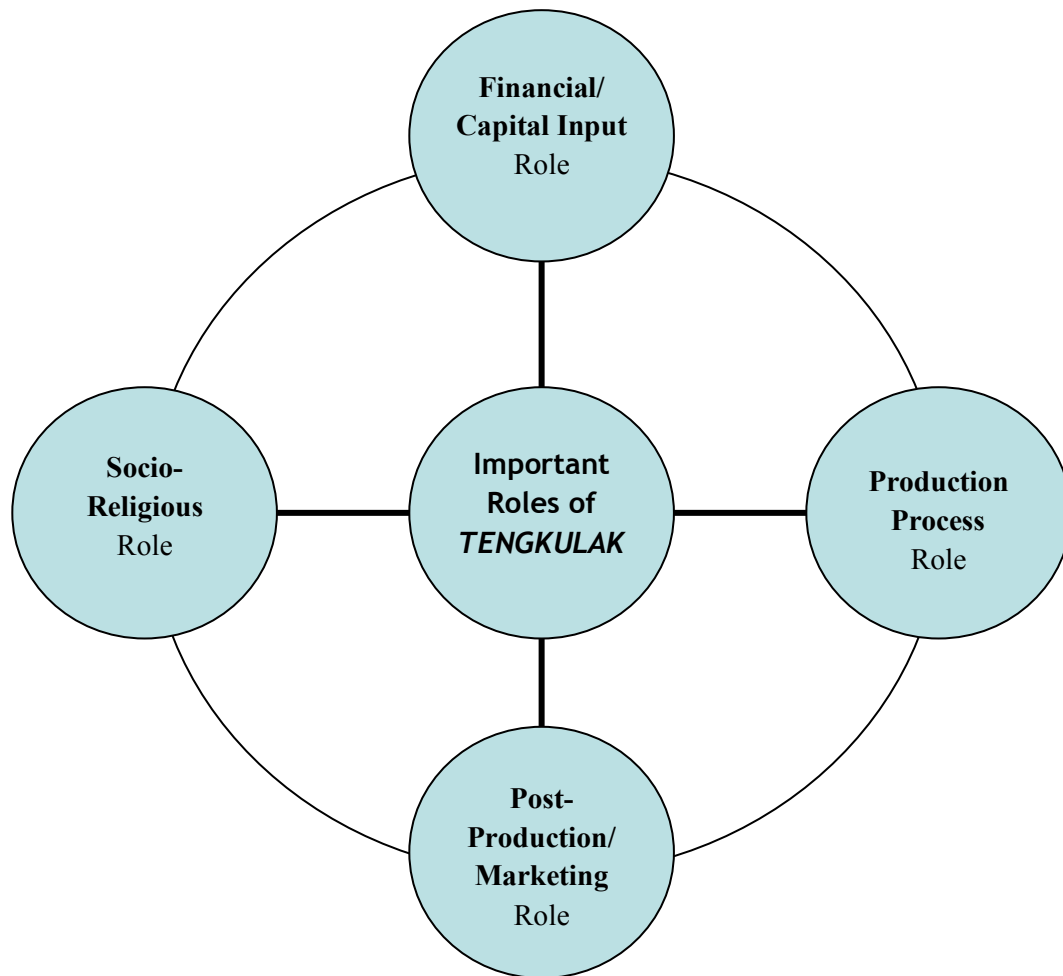


Figure 2. Important Roles of *Tengkulak*/Middleman in Indonesia

The forth role, is the Socio-religious role. There is an additional reason why the *tengkulak* is important in smallholders' community. It is widely known that one of the peculiarities of agricultural products is that they have long gestation period or time lag between production process and output. For instance, the smallholders who are growing estate crops such as cocoa, coffee etc can obtain the cocoa products (to be sold) after 3-4 years (due to a gestation period is 3-4 years). During that time, smallholders need money to finance their daily life such as school fees and medical care for their kids, donation for socio-religious activity etc. An easy way to solve this emergency problem is by borrowing money from the *tengkulak* without any administrative procedures and set working hours (like commercial financial institution or formal banking system require). Then, after harvesting, smallholders sell their agricultural products to the *tengkulak* (as money lender) for low prices (always below prevailing market). Due to a socio-religious function, which tends to be dominant (even though smallholders less benefit economically) in the community, the presence of the *tengkulak* serves an important role.

4. Conclusion

It is important to note that a serious difficulty of smallholders in Indonesia is improving marketing networks of agricultural products. The marketing network in rural area is dominated by brokers (*tengkulak*). Smallholders do not have options to finance their production except for borrowing capital input from the *tengkulak*. Then the *tengkulaks'* money will be repaid by smallholders in terms of agricultural products. It is true that smallholders get capital input, as well as daily life desires easily, on one hand. However, it also true that smallholders have no choice and they are 'choked' by the *tengkulak* in terms of price discrimination on the other hand. This phenomenon affects smallholder's income. However, the *tengkulak* plays an important role in smallholder community. The first role is Financial/Capital Input provider. The *tengkulak* provides access to capital inputs for smallholders who are not able to get formal credit (banks). The second role is Production Process. The *tengkulak* facilitates smallholders in providing agricultural inputs. The third role is of Post-Production/Marketing. The *tengkulak* enables smallholders to sell their agriculture products easily. The forth is Socio-religious role. Smallholders need money for schooling fees, medical care, donation for socio-religious activity by borrowing money from *tengkulak* without any administrative procedures. These facts above depicts that *tengkulak* is not truly enemy of smallholders in the country.

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